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HARMONIZATION, SIMPLIFICATION AND IMPROVEMENT OF THE RULES OF ORIGIN

Options and proposals for harmonization, simplification and improvement of the rules of origin

Study by the UNCTAD secretariat

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CONTENTS

		Paragraphs
	Introduction	1 - 7
I.	Conclusions and policy options for harmonization, improvement and simplification of the rules of origin	8 - 10
II.	Current status of rules of origin	11 - 24
III.	GSP rules of origin and the Uruguay Round Agreement on Rules of Origin: possible prospects	25 - 34
IV.	Suggestions for harmonization, improvement and simplification of GSP rules of origin	35 - 45
	A. Harmonization	35 - 43
	B. Improvement and simplification	44 - 45

INTRODUCTION

1. The twenty-first session of the Special Committee on Preferences adopted the following text on preparations for the 1995 Policy Review:[1]

> "1. The Special Committee on Preferences recommends to the Trade and Development Board that, as part of the preparation for the 1995 policy review, an Intergovernmental Group of Experts on Rules of Origin be established with the following terms of reference: To make proposals to the Special Committee, in view of the policy review on the GSP in 1995, on the simplification, harmonization and improvement of the rules of origin.
>
> 2. In order to facilitate the discussions of the policy review meeting, the Committee requested the UNCTAD secretariat to prepare complementary studies and reviews in the light of the Chairman's summary."

The seventh Executive Session of the Trade and Development Board endorsed the establishment of an Intergovernmental Group of Experts on Rules of Origin. (See the Report of the Special Committee on Preferences on its twenty-first session, annex I.)

2. The present study is designed to serve as background material and a basis for discussion for such a group of experts on the simplification, harmonization and improvement of the rules of origin.

3. In order to facilitate the work of the secretariat, a questionnaire on technical aspects of the Generalized System of Preferences (GSP) rules of origin was sent to all member States of UNCTAD. The replies received are summarized in TD/B/SCP/AC.1/2/Add.1.

4. The last sessional committee on rules of origin was held during the nineteenth session of the Special Committee on Preferences from 18 to 22 May 1992. Although further sessional committees were not established, discussions continued on GSP rules of origin during the twentieth and twenty-first sessions of the Special Committee on Preferences.

5. The Chairman's conclusions on the nineteenth session of the Special Committee contained findings concerning the GSP rules of origin which are recalled below, since they summarize the outcome of the substantive discussions held during the last sessional committee on rules of origin:[2]

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[1] See TD/B/SCP/10.

[2] See TD/B/C.5/145.

"B. Rules of origin had from the outset been a cause of concern to those countries obliged to meet rules of origin requirements. During the current session, the Sessional Committee had an extensive exchange of views on this subject, both formally and informally. From these meetings, the following points which emerged met with widespread agreement, raising hopes for positive improvements:

"(a) Harmonization

(i) The question of harmonization should be treated as an issue separate from other possible improvements, for example, simplification and liberalization.

(ii) It was reaffirmed that the case in favour of harmonization of GSP origin rules had been established.

(iii) The review of GSP schemes, being undertaken by some preference-giving countries, would include rules of origin and their possible harmonization. Options in regard to the basis and scope of any harmonization remained open; however, some movement in favour of the process criterion was evident. A similar trend existed in regard to non-GSP rules of origin.

"(b) Concept of donor-country content

(i) Application of the donor-country concept offered some relaxation of the restrictions contained in rules of origin and would encourage foreign investment and promote international trade.

(ii) It was the view of many countries that extension of the use of the donor-country concept would be consistent with national and international trends towards liberalization of trade.

"(c) Cumulation

Full global cumulation was seen as having positive effects on cooperation among beneficiary countries. It would, in particular, benefit those countries outside regional groupings."

6. The twentieth session of the Special Committee on Preferences did not establish a sessional committee on rules of origin. Instead rules of origin were discussed within its general framework and the Chairman's summary, annexed to the report of the Special Committee, reported that:

"7. Developing countries expressed concern over the lack of progress in harmonizing the rules of origin, which were at present based on two different criteria, namely the process criterion and the percentage criterion. Some developing countries expressed dissatisfaction over the fact that the problem of the rules of origin had not been adequately discussed at the current session of the Committee and suggested that the next session should have the necessary documentation for a comprehensive and detailed review."

7. During the twenty-first session of the Special Committee on Preferences, intensive discussions took place on possible ways and means to proceed towards harmonization, simplification and improvement of the GSP rules of origin. The Chairman, in his summary, noted that:

"10. In connection with a decision of the Committee to establish a Working Group on Rules of Origin as a part of the preparation for the 1995 policy review, a group of countries expressed the view that in doing so the results of the Uruguay Round negotiations and the trend towards regional integration among developing countries should be taken into account."

I. CONCLUSIONS AND POLICY OPTIONS FOR HARMONIZATION, IMPROVEMENT AND SIMPLIFICATION OF THE RULES OF ORIGIN

8. In examining the possible ways to harmonize, simplify and improve GSP rules of origin, it has been considered appropriate in this study to start from the basic elements of the GSP rules of origin and their main problems and accordingly propose the best possible way to proceed, i.e. either through harmonization, simplification or improvement. Rules of origin consist of three elements with which three main problems are traditionally associated:

	Element	**Main problem**
(a)	Origin criterion	Not harmonized
(b)	Direct consignment	Feasibility for LDCs and land-locked countries
(c)	Documentary evidence	Administrative costs.

In the light of the Uruguay Round Agreement on Rules of Origin, it was thought particularly conducive to focus on the total harmonization of the origin criterion among preference-giving countries. As far as direct consignment and documentary evidence are concerned, the quest for simplification of these requirements has been considered as the most suitable approach while it was deemed that improvement of the rules of origin could be best achieved by increasing the scope for cumulation and donor country content. These issues are dealt with in chapter IV below, which includes specific proposals on how to simplify and improve these two aspects of the rules of origin.

9. The key area where discussions should focus during the 1995 policy review is the total harmonization of the origin criterion. The partial harmonization approach, i.e. harmonization within the percentage and process criteria, respectively, would not solve the major problems connected with the origin criterion as two sets of rules would remain applicable to the same product. In order to develop a harmonized set of rules, a technical task force could be established within the UNCTAD secretariat to carry out such work. However, this approach would probably duplicate somewhat the work being undertaken by the Technical Committee under the Uruguay Agreement on Rules of Origin.

10. Under the World Trade Organization (WTO) Agreement on Rules of Origin, the work of the Technical Committee applies only to those rules of origin which are not related to contractual or autonomous trade regimes leading to the granting of tariff preferences. In carrying out this work, it has to be noted that the purpose and one of the major difficulties in developing harmonized rules of origin, whether non-preferential or preferential, is to define the amount of working or processing which could be regarded as substantial transformation. On this issue, the work to be undertaken by the Technical Committee would

be similar to that for GSP rules of origin. Preference-giving countries should be encouraged to consider the outcome of the work of the Technical Committee on non-preferential rules of origin for application to the rules of origin for the purpose of their respective GSP schemes. On the basis of these considerations and those expressed in chapter IV below and in order to avoid duplication, the following proposals are put forward:

(a) The UNCTAD secretariat should as an observer follow and monitor the work carried out within the Technical Committee where possible and, when appropriate, contribute to the technical aspects of its work;

(b) The UNCTAD secretariat will report regularly to the Special Committee on Preferences on the progress and results achieved by the Technical Committee. The Special Committee will provide the secretariat with guidelines for its participation in meetings of the Technical Committee;

(c) Once the Technical Committee has achieved its objectives, the UNCTAD secretariat would propose a harmonized set of rules of origin, including modifications and amendments where appropriate, to UNCTAD member States, for their consideration and adoption.

II. CURRENT STATUS OF RULES OF ORIGIN

11. In order to avoid deflection of trade or circumvention whenever one country starts to differentiate its trade policy towards its partners, rules of origin are the preferred instrument to ensure that the benefits and objectives of trade policy differentiation are confined to the targeted countries. The rules of origin under the GSP schemes are not an exception to this rationale.

12. In today's world trade, two basic kinds of rules of origin exist: non-preferential and preferential. Non-preferential rules of origin are applied in the context of most-favoured-nation (MFN) trade, i.e. application of MFN tariffs, MFA quotas, anti-dumping investigation, etc. Outside of this category, the specific rules of origin contained in free trade area agreements or other instruments of trade policy, such as the Lomé Convention, the Caribbean Basin Initiative and the GSP, are grouped within the basket of preferential rules of origin.

13. Since the start of the GSP system, preference-giving countries had decided to implement their national schemes independently. This resulted in 16 (now 13) different GSP schemes and equally different sets of rules of origin. Each GSP scheme thus has its own rules of origin which have to be complied with in order to take advantage of the GSP preferential tariff. The technical nature and the diversity of rules of origin have brought additional complexity to the GSP schemes and their utilization; for this reason a Working Group on Rules of Origin was established by the second session of the Special Committee on Preferences to harmonize, simplify and improve the rules.[3] For over 20 years, discussions on the rules of origin have concentrated on the best ways and means to attain the final aims of:

(a) Harmonizing the rules of origin; and

(b) Simplifying and improving them.

14. While acknowledging that results have been achieved in some areas, one of the major items for debate and discussion remains unsettled: namely how to achieve harmonization of the rules of origin through the general adoption of either the process or percentage criterion. However, the possible harmonization of GSP rules of origin does not necessarily mean simplification or improvement. Likewise, simplification and improvement do not necessarily involve harmonization. Some countries have argued that the two items should not be dealt with together. In this paper harmonization, simplification and improvement are dealt with separately so as to provide a wider array of possibilities as to the various options to be pursued.

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[3] See TD/B/243/Rev.1, Report of the Special Committee on Preferences on its second session.

15. The following tables represent an overview of the existing regime of rules of origin as of March 1995. The tables attempt to summarize the major features of the different sets of rules currently adopted, seeking to provide a solid background for discussions and consultations.

Table 1

Summary of principal rules of origin

Country/Group of countries	Origin criteria	Requirements	Numerator	Denominator	Percentage level
Australia	Percentage	Minimum local content requirement	Labour and materials from preference-receiving country and other preference-receiving country and Australia	Ex-factory or ex-works cost	Minimum 50%
New Zealand	Percentage	Minimum local content requirement	Expenditure on materials and components originating in the preference-receiving country and other preference-receiving country and New Zealand	Ex-factory or ex-works cost	Minimum 50%
Canada	Percentage	Minimum local content requirement	Local content	Ex-factory price	Minimum 40% for LDCs, minimum 60% for others
United States of America	Percentage	Minimum local content requirement plus "origin" requirement	Cost of materials produced in the preference-receiving country plus the direct cost of processing carried out there	Ex-factory price or appraised value by United States customs	Minimum 35% exact % (column 2)
Norway, Switzerland, European Union and Japan	Process	Change of HS heading. For specific products under the single list: technical tests and/or maximum percentage of imported inputs	Customs value of imported inputs, or the earliest ascertainable price paid in the case of materials of unknown, undetermined origin	Ex-factory price (FOB price in the case of Japan)	Maximum 5%, 40% or 50% where used in the single list
Bulgaria, Czech Republic, Hungary, Poland, Slovakia and Russian Federation	Percentage	Minimum local content requirement	Value of imported inputs	FOB price	Maximum 50%

Table 2

Summary of cumulative origin systems including preference-giving country content ("donor country content")

Country/Group of countries	Scope of cumulation		Donor country content	Documentation	Additional requirements	Other conditions
	Full or partial	Global or regional				
European Union	Partial	Regional	Yes	Certificate needed to indicate use of regional cumulation	Coordinating body of Regional Grouping undertakes to comply with rules	Regional groups must make application and possess central organization capable of ensuring administrative cooperation
EFTA preference-giving countries[1]	Partial	Regional	No	Certificate to indicate regional cumulation	Last exporting country to guarantee accuracy of certificate	Regional economic grouping to make application
Japan	Full	Regional	Yes[2]	Additional certificate required to indicate cumulation		
United States of America	Full	Regional	No	Not specified		(a) Regional cumulation granted (on application to free trade areas and customs unions). (b) Competitive need limits are assessed only against the "country of origin" and not the entire regional grouping
Australia	Full	Global (all preference-receiving countries)	Yes	Not specified		
Canada	Full	Global (all preference-receiving countries)	Yes	Certificate to indicate use of cumulation		
New Zealand	Full	Global (all preference-receiving countries)	Yes	Not specified		
Bulgaria, Czech Republic, Hungary, Poland, Slovakia, Russian Federation	Full	Global	Yes	Certificate must indicate use of cumulation		

1. Among EFTA member States, only Norway and Switzerland apply individually their own GSP schemes. The former GSP schemes of Austria, Finland and Sweden ceased to exist since their accession to the European Union on 1 January 1995.

2. Does not apply to all inputs from Japan.

16. As may be noted from the above tables, preference-giving countries' rules of origin are broadly divided into two main categories: (a) Canada, United States, Australia, New Zealand, Central and Eastern European countries use the percentage criterion; (b) the European Union, Norway, Switzerland and Japan use the process criterion. Moreover, within the preference-giving countries using the percentage criterion, there are marked differences in the amount of minimum local content required and how to calculate it. Among those using the process criterion, the rules of origin were almost completely harmonized between EFTA preference-giving countries and the European Union while marked differences persist between the single list requirements of these two groups of countries and Japan.[4] It has to be noted that the process criterion makes use of percentages in the requirements laid down in the single list of percentages. This mainly concerns machinery and consumer goods where the specific single list rules require that the value of the imported inputs not exceed a certain percentage of the ex-works or FOB price of the finished products.

17. There are also marked differences between preference-giving countries as to the possibilities for cumulation. In this regard, Australia, Canada, New Zealand and Central and Eastern European countries rank at the top in so far as they grant full and global cumulation and donor country content to all beneficiary countries. The European Union, Japan, EFTA preference-giving countries and the United States have preferred to grant regional cumulation to certain regional associations (see table 2). The scope of the regional cumulation facility under the scheme of the European Union differs, however, from that granted by the United States and Japan. The European Union grants what is called partial regional cumulation as opposed to the full regional cumulation granted under the schemes of the United States and Japan. Partial regional cumulation means that inputs imported from another member of the regional association and utilized for further manufacturing or incorporated in the final exporting country must already have originated there in order to be considered as domestic content. This limitation does not occur under the regional cumulation option under the schemes of Japan and the United States where these preference-giving countries consider the members of a regional association as one single customs territory and any working or processing operations may be counted as domestic content to comply with rules of origin requirements.

18. Besides these general differences among the rules of origin of the preference-giving countries which continue to persist, there have recently been unilateral changes in some schemes which need

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[4] For specific examples of such differences see TD/B/SCP/8, 3 March 1994.

to be reported. In November 1993, Japan unilaterally introduced an element of liberalization into its single list requirement concerning the textile and clothing sector.[5]

19. The newly introduced legislation concerning the GSP scheme of the European Union for the period 1995 to 1998[6] contains an important amendment to its GSP rules of origin - the introduction of donor country content. Under this new provision, beneficiary countries may consider inputs originating in the European Union as domestic inputs subject to: (a) the European Union inputs must already be originating in the European Union according to its GSP rules of origin; and, (b) provision of form EUR I issued by the competent authorities in the European Union member State to the certifying authorities of the final exporting beneficiary country and certifying the European Union origin of the inputs used or incorporated into the finished product exported.

20. In 1994, the United States codified a practice in use by United States customs authorities where Form A was no longer required in order to claim GSP status. As a consequence, Section 10.173 of the United States Customs Regulation states that the exporter "shall submit directly to the district director, upon request, a declaration setting forth all pertinent detailed

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[5] See TD/B/GSP/JAPAN/19 of 5 November 1993:

"1. Under the past rules of origin of Japan's GSP, 'Articles of apparel and clothing accessories, not knitted or crocheted', coming under HS Chapter 62 were considered as originating from a GSP beneficiary, only in the case that they were manufactured from textile yarn within the beneficiary. In other words, eligible for GSP were only the articles whose two stages of manufacturing process, namely, from textile yarn to fabrics and from fabrics to apparel, were both made within the beneficiary.

"2. The amendment of the rules of origin relaxed the rule in a way that the articles falling under HS Chapter 62 are eligible for GSP even in the case that they are manufactured from fabrics within a beneficiary. There are some exceptions to the new rule, which are still under the previous conditions. 'Handkerchiefs' of HS heading No. 62.13 and 'Shawls, etc.' of No. 62.14 have to be manufactured from material of fibre (chemical products, etc.), and 'Ties, etc.' of No. 62.15, 'Gloves, etc.' of No. 62.16 and 'Other made-up clothing accessories, etc.' of No. 62.17 have to be manufactured from textile yarn within a beneficiary.

"4. The amendment came into effect after the 1st of November 1993".

[6] See: Council Regulations (EC) No 3281/94 of 19 December 1994 applying a four-year scheme of generalized tariff preferences (1995 to 1998) in respect of certain industrial products originating in developing countries and (EC) No 3282/94 of 19 December 1994 extending into 1995 the application of Regulations (EEC) No 3833/90, (EEC) No 3835/90 and (EEC) No 3900/91 applying generalized tariff preferences in respect of certain agricultural products originating in developing countries, published in Official Journal L 348 of 31 December 1994 as well as Commission Regulation (EC) No 3254/94 of 19 December 1994 amending Regulation (EEC) No 2454/93 laying down provisions for the implementation of Council Regulation (EEC) No 2913/92 establishing the Community customs code, published in Official Journal L 346 of 31 December 1994.

information concerning the production or manufacture of the merchandise...."[7]

21. In the case of the United States rules of origin, there have been certain changes in the legislation concerning GSP rules of origin which need to be pointed out. The original United States GSP rules of origin were contained in the Trade Act of 1974[8] establishing the United States GSP scheme. According to section 503(B) (1) of the Act:

> "The duty-free treatment provided under Section 501 with respect to any eligible article shall apply only:
>
> (1) to an article which is imported directly from a beneficiary developing country into the customs territory of the United States; and
>
> (2) (A) if the sum of (i) the cost or value of the materials produced in the beneficiary developing country plus (ii) the direct costs of processing operations performed in such beneficiary developing country is not less than 35 per cent of the appraised value of such article at the time of its entry into the customs territory of the United States."

22. According to earlier United States Customs information and the statutory law set out in the Trade Act of 1974, GSP origin was acquired if at least 35 per cent of the appraised value of the finished product consisted of:

> "... the sum of (1) the cost or value of the materials produced in the beneficiary developing country, as determined under the applicable law and Customs Regulations, plus (2) the direct costs of processing operations performed in such beneficiary developing country is not less than 35 per cent of the value of the article as appraised in accordance with Section 402 or 402a, Tariff Act of 1930, as amended (19 U.S.C. 1401a, 1402). The 35 per cent criterion can be satisfied entirely by the cost or value of materials produced in the beneficiary developing country, the direct costs of processing operations, or, any combination of the two."[9]

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[7] For the full amended text, see annex I of section 10.173 Customs Rules and Regulations, published in the United States Federal Register, Vol.59, No. 94 - 25569, May 17, 1994.

[8] Trade Act of 1974, Pub. L. No. 93/618 T.T.U.

[9] Contained in TD/B/373/Add.5 of 6 May 1976 and published in the United States Federal Register, Volume 41, No. 67 of 6 April 1977, pp. 14547-8.

23. Thus, the origin determination for GSP purposes was based on the United States percentage criterion (35 per cent rule) with the addition of the intermediate material ruling.[10] This intermediate material rule refers to products where imported material manufactured in the beneficiary country may be counted towards the 35 per cent requirement. United States Customs were of the opinion that if the imported material was manufactured into "a new and different article of commerce" according to the definition of substantial transformation, the whole value of the intermediate material could be counted towards the 35 per cent requirement.[11] However, an important and decisive modification was later introduced to the United States rules of origin by the Customs and Trade Act of 1990 whereby:

> "GSP duty-free treatment applies only to an eligible article which is the growth, product, or manufacture of a beneficiary developing country (BDC), i.e. has undergone substantial transformation in an exporting BDC and which meets the following rules of origin requirements:
>
> "(1) The article must be imported directly from a BDC into the United States customs territory; and,
>
> "(2) The sum of (a) the cost or value of materials produced in a beneficiary country, plus (b) the direct cost of processing performed in such country is not less than 35 per cent of the appraised value of the article when it enters into the United States customs territory. Materials imported into a BDC may be counted toward the 35 per cent minimum value-added requirement only if they are substantially transformed into new and different articles in the BDC, before they are incorporated into the GSP eligible article."

This change was motivated by the desire to align GSP rules of origin with those under the Caribbean Basin Initiative. This important modification introduced the requirement that "origin" in the sense of "substantial transformation", a concept inherited from the United States non-preferential rules of origin, is now required in addition to the 35 per cent rule.

24. In United States legislation and practice "origin" is acquired through "substantial transformation" which is a concept defined by a combination of court judgements and United States Customs administrative regulations and interpretations. Thus the insertion of the "origin" requirement besides the 35 per cent rule introduces a new element of uncertainty and unpredictability for manufacturers and exporters in preference-receiving countries. In

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[10] See Palmeter in Rules of Origin in International Trade: A comparative study, edited by Vermulst, Waer and Bourgeois, Ann Arbor, Michigan University Press, 1993.

[11] The Digest of Rules of Origin (UNCTAD/TAP/133/Rev.6), contains examples of such substantial transformation.

fact, the main problem of such definition of "substantial transformation" or "origin" relates to the fact that such kinds of origin determination obtained through court rulings or administrative decisions tend to be highly specific to the litigation and as such provide little evidence or guidance in assessing whether or not a certain manufacturing operation confers origin. In the opinion of an eminent United States lawyer,[12] this change represents a step backwards in respect of past legislation. In addition, the present text seems to be inconsistent with the requirements laid down in the Common Declaration. According to Article 3 of the Declaration, origin determinations should be "clearly defined". Subparagraph (a) (i)-(iii) of the same article provides for three ways to make such a determination: change of tariff heading, ad valorem percentage or technical test. The concept of "substantial transformation" applied through case-law and United States customs determinations or interpretations do not seem to meet the criteria of transparency and predictability laid down in the Common Declaration. From the point of view of preference-receiving countries, it would be appropriate and desirable to apply origin criteria which better suited the expectations of exporters and manufacturers in a clear and precise statutory law.

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[12] Palmeter in Vermulst, et al, op.cit.

III. GSP RULES OF ORIGIN AND THE URUGUAY ROUND AGREEMENT ON RULES OF ORIGIN: POSSIBLE PROSPECTS

25. The problems and difficulties encountered by beneficiary countries in utilizing and complying with GSP rules of origin, as briefly reported in the replies to the questionnaire (see TD/B/SCP/AC.1/2/Add.1), were partly shared in another context by those countries which found themselves involved in origin determination cases arising within the framework of non-preferential origin. For a long time and in different contexts, non-preferential and preferential rules of origin followed a parallel track in the sense that neither was harmonized: each country could use a different set of rules depending on the trade policy instrument (i.e. one set of rules for GSP, another for anti-dumping investigations and another for MFA quotas, etc.). In fact, after the entry into force of the Customs Valuation Code in 1980, negotiated under the Tokyo Round in 1979, and of the International Convention on the Harmonized Commodity Description and Coding System, developed under the auspices of the Customs Cooperation Council in 1988, rules of origin remained the only one of the three basic customs laws operating at the national level and not regulated or harmonized at the multilateral level. The Uruguay Round negotiators, aware of the growing importance of rules of origin in world trade, finally reached an agreement on rules of origin which has now become an integral part of the results of the Uruguay Round negotiations.

26. The Agreement[13] broke new ground in two respects. First, it brought into GATT discipline non-preferential rules of origin; secondly, it aimed to harmonize these rules through a detailed procedure involving the World Customs Organization. The text of the Agreement deals exclusively with non-preferential rules of origin while preferential rules of origin are dealt with in the "Common Declaration with regard to Preferential Rules of Origin", contained in annex II to the Agreement. In this text, the GSP rules of origin are clearly referred to in paragraph 2, which mentions: "For the purpose of this Declaration, preferential rules of origin shall be defined as those laws, regulations and administrative determinations applied by any Member to determine whether goods qualify for preferential treatment, under contractual or **autonomous trade regimes**...." [Emphasis added]. In the GSP context, the Declaration reiterates the call for transparency and predictability in the application of the rules of origin, thus somewhat echoing the agreed conclusions reached at past UNCTAD Sessional Committee meetings.

27. A closer look at, and a first overall assessment of, the value of the Declaration from a GSP perspective gives the impression that the Common Declaration represents basically a "standstill" as far as GSP rules are concerned. It provides and ensures requirements that, in general, have already been achieved

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[13] For the whole text of the Agreement, see GATT document ISBN 92-870-1121-4 published 4 June 1994.

and implemented in the GSP rules of origin[14] of preference-giving countries with two notable exceptions, as set out in subparagraphs (d) and (f). Under the provisions of paragraph 3 subparagraph (d) "The members agree to ensure that: (d) upon request of an exporter, importer or any person with a justifiable cause, assessments of the preferential origin they [member States] would accord to a good are issued as soon as possible but no later than 150 days.... Such assessments shall remain valid for three years provided that the facts and conditions, including the preferential rules of origin, under which they have been made remain comparable." This provision of the Common Declaration marks a step towards transparency and predictability in this area which had previously been left to the national customs laws of WTO member States. In practice, the provision aims at establishing binding origin information on preferential rules of origin. Through this procedure, exporters in preference-receiving countries may request from the preference-giving countries' customs authorities a prior origin ruling related to specific cases or products that they wish to export in order to find out whether or not they are eligible for GSP treatment. From the point of view of beneficiaries, this provision may contribute to solving complicated origin questions involving technicalities which were dealt with previously by national procedures, where existing, but were not agreed at multilateral level. Additionally, the three years of validity of the ruling and the provision of 150 days within which to provide such information improve the transparency and stability of the system. What remains to be seen is how this undertaking agreed within the framework of the Common Declaration is going to be implemented through the national legislation of the preference-giving countries. There may be little doubt that such an undertaking is binding on WTO member States since the wording of paragraph 3 of the Declaration states that "Members agree to ensure that...." Furthermore, although the Declaration is contained in annex II to the Agreement on Rules of Origin, Article II, paragraph 2 of the Marrakesh Agreement establishing the World Trade Organization provides that the Agreements and associated legal instruments form an integral part of the WTO Agreements, binding on all members. Moreover, the binding character of the annexes has been indirectly demonstrated by the establishment of the Technical Committee as provided in annex I to the Agreement. Therefore, preference-giving countries, members of the World Trade Organization, will be expected to implement in their national legislation as a specific text of law a mechanism ensuring the proper and consistent application of such an undertaking.

28. In addition, subparagraph (f) of paragraph 3 of the Declaration provides:

> "any administrative action which they take in relation to the determination of preferential origin is reviewable promptly by judicial, arbitral or administrative tribunals or procedures, independent of the authority issuing the

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[14] As far as the United States GSP rules of origin are concerned, see paragraph 21.

determination, which can effect the modification or reversal of the determination;"

Although this provision has already been implemented in general customs legislation of preference-giving countries, reiterating it strengthens and emphasizes the necessity of an improved judicial review mechanism of the origin determinations made by the customs authorities of preference-giving countries. This provision likewise emphasizes the necessity of a "prompt" judicial review being carried out by "judicial, arbitral or administrative tribunals or procedures, **independent of the authority issuing the determination**;" [Emphasis added].

29. Conversely, the absence in the text of any explicit mention that exporters should also be entitled to file a complaint against the origin determination made by the importing country as expressly provided for in the Declaration in subparagraph (d) is to be regretted.

30. In examining the content and extent of the Declaration which concerns GSP rules of origin, it has to be acknowledged that the core text of the Agreement on Rules of Origin concerns non-preferential rules of origin. In this context, it clearly aims at achieving two basic objectives:

(a) Harmonization of non-preferential rules of origin;

(b) The rules of origin, once harmonized, should be used for all non-preferential purposes (mainly MFN tariffs, anti-dumping and countervailing duties, safeguard measures, etc.).

31. Part IV of the Agreement on Rules of Origin, entitled "Harmonization of Rules of Origin", deals specifically with, inter alia, the work programme for establishing a set of harmonized rules of origin. While under Article 4 of the Agreement, a Committee on Rules of Origin is established, the actual elaboration of the harmonized rules is to be carried out by a Technical Committee "under the auspices of the Customs Cooperation Council" (now the World Customs Organization) (Article 4, paragraph 2). According to Article 9 paragraph 2 (c) of the Agreement with reference to the work programme, the Technical Committee should first develop harmonized definitions of: "(i) Wholly-Obtained and Minimal Operations Processes" or to "consider and elaborate upon..." "(ii) Substantial Transformation - Change in Tariff Classification" and "upon completion of the work under subparagraph (ii)..." it should "consider and elaborate upon..." "(iii) Substantial Transformation - Supplementary Criteria." It is likely that the major focus of the work within the Technical Committee will be concentrated on (ii) and (iii) since the concept of substantial transformation has traditionally been considered the core of the rules of origin. In addition, it is important to note that the Agreement clearly provides that the Technical Committee will elaborate upon, on the basis of the substantial transformation criterion, "...the use of change in tariff sub-heading or heading...." Additionally, the

work of the Technical Committee will be divided "on a product basis taking into account the chapters or sections of the HS nomenclature...."

32. Article 9 paragraph 2(c)(iii) provides for the Technical Committee to consider and elaborate upon supplementary criteria to be used "when, upon completion of the work under subparagraph (ii) (i.e. the work based on the change of tariff heading criteria) for each product sector or individual product category ... the exclusive use of HS nomenclature does not allow for the expression of substantial transformation". Such supplementary criteria might be "ad valorem percentages and/or manufacturing or processing operations".

33. From the GSP perspective, the Agreement and its work programme solve the unsettled question of whether the harmonization of GSP rules of origin has to be carried out by adopting an across-the-board percentage criterion or the process criterion. The provisions of the above-mentioned Agreement place the change of tariff heading at the very foundation of the harmonization process of the non-preferential rules of origin.

34. The percentage criterion (referred to as "ad valorem percentages") comes into play only as supplementary criteria in defining "substantial transformation" and only after the exclusive use of the HS nomenclature is not satisfactory to comply with "substantial transformation". According to paragraph 2(a) of Article 9, the work programme of the Technical Committee must be completed within three years of its initiation.

35. The Technical Comittee on Rules of Origin held its first session in Brussels at the World Customs Organization from 6 to 10 February 1995. The opening was attended by the Secretary General of the World Customs Organization (WCO) and the Director General of WTO. In their addresses to the inaugural session, both speakers emphasized that the principal task of the Technical Committee was to develop a harmonized set of rules of orgin based on impartial and technical work aimed at simplifying and liberalizing world trade.

36. The Committee's agenda included work on the rules of procedure, i.e. election of officers, voting system, etc., and the method of work. Under this latter item, different options on the organization and presentation of the work were discussed. A proposal by the United States was widely debated including the need for explanatory notes to the final text and whether or not such notes were to be considered binding. The United States and European Union delegations suggested starting the work with the less troublesome HS chapters. The Chairman concluded that the WCO secretariat would eagerly await proposals regarding the format for presentation and the order of work. On substantive issues, discussions centered on proposals put forward by the WCO concerning the definitions of "wholly obtained goods" and "minimal operations or processing".

37. Finally, the Chairman of the Technical Committee requested participants to provide, by 15 April 1995, written contributions to the points discussed during the first session, namely:

"(1) The format for presentation of the results of the second phase of the work programme;

(2) The order in which the HS chapters should be examined in phase II;

(3) The status of free port and in-bond operations in relation to the definition of "country" or "place of origin";

(4) Further elaboration of terms in definition 3 (c): to be based on "nationals" or "responsibilities";

(5) Definition of "vessel";

(6) Interpretation of "solely";

(7) Definition and coverage of "waste and scrap" in "wholly-obtained goods"; and,

(8) Definition and coverage of minimal operations or processes".[15]

It was agreed that the second session of the Technical Committee would take place from 10 to 14 July 1995.

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15 See document 39310 E of 10 February 1995, WCO First Session of the Technical Committee.

IV. SUGGESTIONS FOR HARMONIZATION, IMPROVEMENT AND SIMPLIFICATIONS OF GSP RULES OF ORIGIN

A. Harmonization

38. In recent years, growing global economic interdependence and the flourishing of regional agreements have increasingly cast doubt on the old theory of the "neutrality" of rules of origin. It had been argued that, in principle, rules of origin must be impartial and crystal-clear in order to facilitate world trade. According to this vision, if the concept of free trade were taken to its extremes, the world would not need to have rules of origin, neither preferential nor non-preferential. In reality, however, rules of origin are becoming increasingly an issue in world trade as they serve, and are often modelled on, deliberate trade policy choices. This has been clearly demonstrated in world trade practices by the use made of rules of origin in anti-dumping investigations and in the negotiations on free trade areas. Origin determination in the context of anti-dumping proceedings is closely connected with the outstanding issue of the anti-circumvention procedures of anti-dumping orders. In the context of preferential rules of origin of a contractual nature, i.e. in the case of free trade agreements, they serve to regulate the trade patterns of the Contracting Parties. Strict rules of origin in a free trade area may affect upstream or downstream third-country producers of inputs. Conversely, excessively flexible origin rules may encourage sourcing of inputs outside the free trade area and may potentially affect the domestic industries of the Contracting Parties.

39. GSP rules of origin also serve to attain specific trade policy objectives and are preferential rules of origin. However, GSP rules of origin carry, among the plethora of existing rules of origin, two clear and distinct connotations. First, the GSP rules have been implemented autonomously. As such they are not the result of strenuous bilateral negotiations but are the expression of the autonomous character of the GSP concession as a whole. This autonomous nature has been recognized in the Common Declaration which distinguishes between autonomous and contractual preferential rules of origin. Secondly, from the outset, GSP rules of origin have served as an integral part of the GSP system's declared policy objectives, namely, to promote industrialization, increase export earnings and accelerate the rate of economic growth which are common to all GSP schemes.

40. As previously mentioned, besides GSP, the preferential rules of origin field covers almost all areas where preferential rates of duty are granted as a result of agreements, such as free trade areas, asymmetrical bilateral arrangements and customs unions. To expect world-wide improvement or harmonization of such rules would be, at the least, unrealistic, as the rules contained in such agreements are directly the result of the objectives contained in the agreements, and harmonization, although desirable, would not satisfy the intentions of the contracting parties.

41. Such differences in objectives do not occur in the case of GSP rules of origin because the rules are there to serve the basic objectives of the GSP which, as mentioned, are common to all GSP schemes and were recently reaffirmed as fully valid by the twenty-first session of the Special Committee on Preferences.

42. The entry into force of the Uruguay Round Agreement on rules of origin establishes multilateral rules in this area and provides for harmonization of non-preferential rules of origin. Such improvement in the multilateral set of rules governing world trade cannot be ignored in the efforts towards harmonization of GSP rules of origin. After the non-preferential rules of origin, the GSP rules are the ideal candidate for harmonization since they are autonomous (not the object of bilateral obligations) and they serve the common trade policy objective of the GSP which could be better achieved through the harmonization of such rules.

43. Once a distinction has been made between autonomous and contractual preferential rules of origin, the argument for the harmonization of GSP rules becomes clear. The scheduled harmonization of non-preferential rules of origin already has a bearing on the crucial debate over whether possible harmonization of GSP rules should be based on the percentage criterion or the process criterion. The clear adoption of the process criterion in the context of the non-preferential rules of origin would undoubtedly contribute to resolving the dispute and provide scope for harmonization.

44. In agreeing to establish a multilateral and harmonized set of non-preferential rules of origin, the members of WTO have declared themselves in favour of pursuing the following objectives:

> "Recognizing that clear and predictable rules of origin and their application facilitate the flow of international trade;
>
> Desiring to ensure that rules of origin themselves do not create unnecessary obstacles to trade;
>
> Recognizing that it is desirable to provide transparency of laws, regulations, and practices regarding rules of origin;
>
> Desiring to ensure that rules of origin are prepared and applied in an impartial, transparent, predictable, consistent and neutral manner;
>
> Desiring to harmonize and clarify rules of origin".

This Declaration of Intent is indeed similar to the objectives and reasons for harmonizing GSP rules of origin. The scope for harmonizing GSP rules of origin is further strengthened by developments outside the origin context. The tariff reduction agreed among preference-giving countries will further erode the preferential margin which is the economic incentive for utilizing

the GSP. Different sets of rules of origin, coupled with a low margin of preference, may deter manufacturers in preference-receiving countries from utilizing the GSP schemes and thus undermine the economic rationale of the GSP.

45. Whatever might be the course of action or developments might be in the area of rules of origin, the technical determination of origin, in both the preferential and non-preferential contexts in major developed countries, is today closely intertwined. The ambitious agenda and work entrusted to the Customs Cooperation Council to elaborate a harmonized set of non-preferential rules of origin based on the process criterion will have to be undertaken against the imposing background of the existing rules of origin, and ought to include GSP rules.

46. In drawing up suggestions for the harmonization of GSP rules of origin, the work to be carried out by the Technical Committee charged with the elaboration of the non-preferential rules of origin should form the basis for harmonizing GSP rules of origin. Already some preference-giving countries have indicated that this work programme would be a possible way to achieve harmonization. The value and the technical nature of this exercise was demonstrated at the first meeting of the Technical Committee where delegations from preference-giving and receiving countries met to establish administrative procedures and decide on the organization of work. The UNCTAD secretariat should, as an observer, follow the work of the Technical Committee and report on the result to the Sessional Committee on Rules of Origin during the twenty-third session of the Special Committee. Based on the outcome and developments of the work undertaken within the Technical Committee, preference-giving and receiving countries may wish to further pursue the quest and prospects for harmonizing GSP rules of origin, on the basis of a solid and practical background.

B. Improvement and simplification

47. Besides the case established for harmonization, there are concurrent exigencies and demands for improvement and simplification of the current GSP rules of origin as reflected in the replies provided by preference-receiving countries. Overall it has to be noted that certain features of the GSP rules of origin have been established since the outset of the schemes, that is nearly a quarter of a century ago. Therefore, some technical aspects of the rules simply need only to be updated and simplified in order to be aligned with the profound changes in world trade which have occurred over time. As mentioned, the substantial reduction of MFN duties agreed on during the Uruguay Round and other previous Rounds has substantially narrowed the scope for maintaining stringent rules of origin and rigid administrative procedures. Such developments call for a relaxation of the present rules of origin if the economic efficiency of the GSP system is to be maintained. Circumvention and deflection of trade, the two main reasons for maintaining strict origin requirements, appear to have lost their validity in justifying the actual status of the rules of origin. Over the years of operation of the GSP, customs

authorities in preference-giving countries have surely gained sufficient knowledge of GSP trade patterns to cope with possible doubts about origin. Since the recent introduction and/or application in some schemes of country or country-product graduation, which has affected major beneficiaries, it cannot be reasonably expected that the remaining middle and low-income GSP beneficiaries will fulfil the strict origin criteria required for industrial products or support the excessive administrative burden of complying with GSP rules of origin.[16]

48. On the basis of the above-mentioned points and taking into account the answers provided by preference-receiving countries to the questionnaire, the following suggestions are proposed for the improvement and simplification of the present GSP rules of origin:

(a) As outlined above, the adoption by all preference-giving countries of the binding origin information, as provided in the Common Declaration, would certainly help to impart further legal certainty and transparency into rules of origin. This provision should be applied in a specific text of law implementing the Uruguay Round Agreement rather than left to general administrative guidelines;

(b) The additional requirements as to the origin criteria, namely the certificate of origin Form A and the direct consignment rule, have remained unchanged in substance since the inception of the GSP schemes. In order to ease the administrative burden and costs of the documentation to be provided for each GSP transaction, it is recommended that certain peculiarities derived from the early years of GSP be amended as follows:

(i) Such rules concerning transshipment as the provision of the bill of lading should no longer be an additional requirement to obtain GSP treatment. Land-locked countries, middle-income countries with poor infrastructure and services are often unable to comply with this requirement. These countries are not in a position to provide their exporters with a bill of lading covering the passage through the country of transit. From the outset, Australia and New Zealand did not require such documentation and have not reported any problems as a result. A first step would be to abolish such a requirement for LDCs.

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[16] For a discussion and overview of such stringent criteria, see "Consultations on harmonization and improvement of the rules of origin" (TD/B/SCP/8 of 3 March 1994).

(ii) The rules of direct purchasing in the GSP schemes of Central and Eastern European countries and the obligation to indicate the final consignee in Box 2 of GSP Form A under the Canadian GSP scheme should be aligned with the facilities existing in preference-receiving countries. Such requirements, especially for LDCs and middle-income countries, are tantamount to exclusion from the GSP schemes of these countries.

(c) The requirements concerning the size, format and quality of paper of GSP Form A should be eased, at least for LDCs. The purpose of maintaining the requirement that a certain quality of paper must be used to print the Form was to avoid any misuse of it. Modern techniques and practices could easily circumvent or lead to misuse a GSP Form A despite this requirement. Furthermore, such a format is a heavy burden for preference-receiving countries and especially LDCS. The UNCTAD secretariat annually receives many requests for these forms from countries which are unable to print them according to the format. Additionally, Form APR, scarcely used and required only by some preference-giving countries, should be abolished and replaced by a simple invoice declaration of origin.

(d) The notes on the back of GSP Form A need to be updated following political changes which have occurred since the last revision. In particular, the name European Economic Community should be changed to European Union, while Union of Soviet Socialist Republics should be changed to Russian Federation. In place of Czechoslovakia there is now the Czech Republic and Slovakia. Since Austria, Finland and Sweden became part of the European Union these names should be deleted in Part III (3) of the Notes. The note marked with asterisks concerning the United States should be replaced by an insertion in the text as follows: "The United States do not require GSP Form A. A declaration setting forth all pertinent detailed information concerning the production or manufacture of the merchandise is considered sufficient only if requested by the District Collector of Customs".

(e) While the issue of cumulation has been extensively dealt with in TD/B/SCP/8 on "Consultations on harmonization and improvement of the rules of origin", some ideas for improvement in the area of regional cumulation are set out as follows:

(i) In the context of regional cumulation granted under the United States scheme, inputs from graduated countries, such as Singapore and Brunei Darussalam, should continue to be counted as originating materials for ASEAN cumulation purposes. The graduation of countries members of a regional association should not entail the exclusion of their inputs in the context of regional cumulation as this

procedure may disrupt the established patterns of trade and investments in the region and frustrate its economic integration process which is the main reason for granting such kinds of cumulation;

(ii) Under the regional cumulation rules of the European Union, the requirement for Form A covering inputs from other countries should be replaced by an invoice declaration provided by the supplier;

(iii) While full and global cumulation among preference-receiving countries remains the preferred option for improving rules of origin, other forms of cumulation could be studied for those preference-giving countries (i.e. United States, Japan and the European Union) which provide cumulation on a regional basis only. An alternative form of cumulation could be used for LDC or middle-income countries which do not belong to a regional association or where the secretariat of the regional association is not yet in a position to fulfil the necessary administrative requirements. Such cumulation could involve an LDC and a beneficiary neighbouring country upon evidence that the necessary requirements to ensure the proper administration of the cumulation is assured by the preference-receiving countries' authorities. For example, Indian inputs could be used in a manufacturing process in Bangladesh or inputs from South Africa could be used in Namibia, etc.

(f) Besides cumulation, there is ample justification for providing a commonly agreed procedure for derogations for LDCs. The European Union's rules and procedures for such a derogation could be used as a model provided that the application could be made by private persons through the certifying authorities in the LDC beneficiary.

(g) Administrative cooperation should be strengthened between those countries requiring official certification of Form A and preference-receiving countries. This would require additional efforts from the preference-receiving countries' certifying authorities which have to maintain a working relationship with their counterparts in preference-giving countries. In particular, they should ensure that during verification procedures, or in the case of reasonable doubt, all the information be made available to the customs authorities of the preference-giving countries. However, the latter should refrain from demanding unreasonable adherence to laws and regulations but rather exercise good faith and judgement on a consistent case-by-case basis.